The taxpayer's watchdog for over 65 years
ARIZONA TAX RESEARCH ASSOCIATION

BUDGET DEFICIT PROVIDES OPPORTUNITY TO IMPROVE FINANCIAL MANAGEMENT

Much of what drives state government expenditures involves formulas. Some formulas are as simple as multiplying an established dollar amount by the number of people served, or eligible to be served, by a particular program. In most cases, however, spending formulas are considerably more arcane and complex. Undoubtedly, formulas can be useful tools in the budget-making process, providing benchmarks to determine annual funding levels.

As with other tools, however, it is unwise to allow these state funding formulas to run on automatic, performing the appropriator's work unchecked. In too many cases, formulas contain hold harmless provisions, merge with other formulas, or become obsolete altogether. This results in spending that lacks accountability or that is replete with redundancies. These same flawed spending formulas are sometimes referred to as "statutory" or "non-discretionary" or are grouped unnecessarily with voter-mandated spending.

ATRA has pointed out that budget deficits provide a good opportunity for legislators to simplify, repair, and regain control of these formulas and, to a considerable extent, the appropriations process. The 48th Legislature should make every effort to avoid the kind of budgets in the past that have relied on deficit financing and gimmickry.

The following are several specific recommendations to reform such problematic formulas in K-12 and higher education that are the result of either flawed policies or simply sloppy budgeting. ATRA encourages the Legislature to apply similar scrutiny to other statutory formulas such as those in corrections, health care, and retirement funding.

Don't exaggerate your obligation to adjust for inflation: Since its enactment in 2000 by Prop. 301, the Legislature has exaggerated its requirement to increase school funding under §15-901.01. Through FY 2006, this statute required the Legislature to "increase the base level ***or*** other components of the revenue control limit" [emphasis added] by 2%. Some have argued that (for the purposes of this statute only, apparently), *or* means *and*. Therefore, goes the argument, the Legislature is required to apply the 2% factor to both the base level and other components of the revenue control limit (RCL). Despite serious budgetary problems in years past, the Legislature chose to adjust *both* the base level *and* the transportation support level by 2%. From and after FY 2007, this statute requires the Legislature to make such inflation adjustments by the GDP price deflator or 2%, whichever is lower. During the 1990s, mandatory inflation adjustments were purposefully removed from statute because of the detrimental impact they can have on the appropriations process in lean years. Simply put, increases in funding to hold government harmless from the impact of inflation should not be automatic. Citizens and taxpayers are not necessarily held harmless from the impact of inflation. If the Legislature wants to enact inflation adjustments, it should make that decision because it desires to do so and it has the revenue to do so — not because a statutory formula requires it.

Reform agency authority to transfer line item funds between budgets: State agencies have the authority, subject to approval from the Department of Administration, to transfer funds between line items of their budgets in order to balance revenues with expenditures within a budget. In FY 2005, the Superintendent of Public Instruction used this authority to transfer $10 million in excess "additional state aid" revenue from the state general fund to fund a new tutoring program. The budget transfer authority was not intended to allow agency heads to circumvent the appropriations process to use "found money" to create new programs. The Legislature should reform this policy to maintain the integrity of the appropriations process.

Manage the general fund exposure to additional state aid costs: "Additional state aid" is money that the state pays to school districts in recognition of what residential property taxpayers would pay were it not for the homeowner's rebate and the one-percent constitutional cap on primary taxes. Despite efforts to contain property tax growth through the state's adherence to the truth-in-taxation laws (TNT), growth in local school district property taxes for desegregation/OCR, excess utilities, career ladder, and transportation will result in increased exposure to the state general fund. For FY 2008, the Legislature appropriated $359,013,100 in additional state aid. The Governor's veto of HB2143 in 2005 and SB1206 in 2006 prevented some progress on this issue. The state should minimize its exposure to homeowner rebate and one-percent cap costs by capping or phasing out local school district levies that are outside the public school equalization system.

Phase out career ladder: Despite the fact that Prop. 301 helped set a policy direction toward performance pay for all school districts in the state, 28 school districts still have the legal authority to participate in a "career ladder" program. The number of participating districts was capped as of FY 1994 because of concerns raised about the cost and effectiveness of the program. Because it is available to only 28 districts, career ladder contributes greatly to inequities in Arizona's school district spending and taxation.

For FY 2008, the state general fund exposure for career ladders is $38 million. In addition, property tax levies on residential property for career ladder also exposes the state general fund to additional state aid costs of $10 million.

Move from the "prior year plus growth" to current year funding: School district funding is based on the prior-year's 100th day student count plus current-year growth. The system therefore holds districts harmless for reductions in enrollment from the prior year, even though state taxpayers may be funding those very same students at another district or charter school.

Ensure districts properly report students: The Legislature needs to continue to develop better oversight over student counts to ensure that the growing demands on taxpayers to fund student growth are legitimate. Recent press reports regarding fraudulent accounting of students in some school districts suggest there is need for better auditing at the state level.

Districts are allowed to adjust their student counts in certain circumstances, such as widespread illness or adverse weather conditions. Surprisingly, this list also allows an adjustment for "concerted refusal by students to attend classes for three consecutive days or more." Again, sometimes these students are actually attending another district or charter school.

Eliminate or reduce rapid decline funding: School districts that experience declining enrollment for more than one year (they are held harmless automatically for the first year) may be eligible for additional "rapid decline" funding. ATRA supported the Legislature's successful effort to fund rapid decline at 50% in recent years. However, continued efforts are needed to reduce the level of ghost funding in the K-12 system.

Eliminate invisible square footage for new construction qualification calculations: School district square footage that is built with local option dollars (class B bonds or overrides) is invisible to the state, while students within the walls of that square footage are not invisible in the "pupil per sq. foot" calculation to determine if a school qualifies for new construction.

Eliminate automatic 5% additional funding for statutorily-defined "rural" districts: Students FIRST statutes require the School Facilities Board (SFB) to add 5% to new construction and building renewal formulas for "rural areas." Rural is defined as a district outside a 35-mile radius from the boundary of a municipality with a population of more than 50,000. The formula generates some interesting results. Globe is rural; Miami is urban. Skull Valley is rural; Kirkland is urban.

Allocate university appropriations in accordance with enrollment growth: For primarily political reasons, general fund appropriations to the universities have strayed considerably over the years from the growth formula guidelines. The result is that there now exists a sizeable per-student funding inequity between Arizona's three public universities. The Legislature should begin immediately to close this funding gap by appropriating whatever dollars are available for the universities proportionate to where enrollment growth is occurring.

Eliminate the community college hold harmless formula: Operating state aid for colleges increases through student growth but never decreases for declining student counts. For example, say a hypothetical district started with 1,000 full time student equivalents (FTSE). In the following year, that district's student count declined resulting in 800 FTSE. The funding formula holds the district at the 1,000-FTSE funding level. A district's operating state aid cannot be increased until the FTSE count exceeds the highest recorded FTSE since FY 2004. Community college funding should be reformed so that student-based funding follows the students without hold harmless mechanisms.

Reduce or eliminate redundant funding through dual and concurrent enrollment: Community colleges, high schools, and joint technological education districts often enter into agreements that can result in two or more entities counting the same students for the same seat time for funding purposes. Funding should go only to the entity providing the services or should be distributed proportionately.

Eliminate the community college "equalization assistance" formula: Four of Arizona's eight "rural" community college districts qualify for equalization assistance from the state general fund. The key driver in this formula is the average net assessed value (NAV) for the eight districts. The further a district is from the average, the more money it gets from the state. The formula for FY 2008 resulted in a $23.5 million cost to the general fund. Unbelievably, the FY 2009 requirement skyrockets to $29 million. In fact, this formula, which distributes monies to colleges without regard to changes in student growth, has climbed 161% in the last five years. The equalization assistance formula was designed to provide money to Eastern Arizona College when the system was established. If the formula were eliminated, the state could support Eastern through direct appropriation.

Eliminate the out-of-county reimbursement subsidy: Counties that are not part of a community college district are charged an "out-of-county" reimbursement for students from their county that attend one of Arizona's community colleges. This charge is in recognition of the fact that taxpayers in those counties (Apache, Greenlee and Santa Cruz) are not funding a district of their own. This reimbursement is based on the college's per-student level of expenditures minus the college's per-student amount of state aid. For years, the affected counties have argued the charges are excessive and inequitable. Instead of correcting this inequity, the Legislature subsidized these counties with state monies to partially offset the payments. The Legislature should eliminate the subsidy and should correct the reimbursement formula to only include the per-student amount of property tax dollars raised by the college district.

Eliminate state aid to community colleges for recreational classes: The state's taxpayers have an interest in providing funding to community colleges for academic and technological training. However, taxpayers should question what the state is paying for when credit is awarded for recreational courses and as such receive state funding. Courses like *Single Again, Coping with Stress, Humor and Play*, and *Creative Grandparenting* have appeared in community college catalogs. Other courses that have been offered in Arizona community colleges might lead one to question whether they are truly at a college level: *Approaching Math Positively, Notetaking, Testing Tips,* and *How to Study* have been offered for college credit and therefore generate state funding.

Reduce formulaic funding for online courses or "virtual" schools: Notable expansion and growth has occurred in the online delivery of courses in higher education and K-12. Funding adjustments should be made for schools that employ delivery methods that do not require the level of funding needed in more traditional environments.

Stop adding to the problem: Every year, the Legislature is asked to codify in statute formulas that further erode the Legislature's flexibility to deal with spending demands and priorities. Worse, in order to side-step the difficulty of funding new programs, the costs are often phased in, leaving to future legislatures the real burden of funding them.